Supreme Court of the United States

THE PEOPLE OF THE STATE OF NEW YORK,
Appellants,

AGAINST

GAMBLE LATROBE, JR., JAMES B. KNOWLES and WILLIAM S. ERICHS, trustees in bankruptcy of THERMIODYNE RADIO CORPORATION,
Appellees-Petitioners.

October Term,
A. D. 1928.
No. 601.

PETITION FOR REHEARING.

Come now the above-named appellees-petitioners and present this, their petition for a rehearing of the above-entitled cause, and, in support thereof, respectfully show:

I. The ground of distinction found by the court between this case and the *Air-way Case* is a novel one which was not considered by the courts below or raised in the argument before this court.

The opinion suggests that the basis of the tax in the *Air-way Case* was the mere authority to issue stock, a privilege not fully exercised, but in the present case was the number of shares actually used in carrying on business within the State. This distinction implies that a corporation "uses" its shares of stock in carrying on its business or, in other words, that there is such a relation between its

capital structure and its business that the form of the one is a proper measure of the other.

That there is such a relation is assumed by the court without reference to authority, legal or economic, and without further discussion.

This novel point of view was not considered by the courts below, was not argued in this court and is believed never to have been expressed in any previous opinion of this court. If the details of the internal structure or capitalization of foreign corporations having no relation to the amount of its property or business are to be made the basis of franchise taxes by the states within which such corporations desire to transact business, a new chapter in the taxation of foreign corporations has opened.

As a matter of fact, there is no relation whatever between the transaction of the corporate business and the form of the capital structure. The number of shares of stock into which the capital is divided fixes the rights of stockholders as among themselves and with respect to the property, earnings and management of the corporation, but does not affect its dealings with third persons or any of its acts as an entity.

Counsel desire an opportunity to show to the court that the distinction suggested by the opinion between this case and the *Air-way Case* is illusory.

II. The decisions cited in the opinion as sustaining franchise taxes based on par value treated such par value as representing property.

In *St. Louis Southwestern Railway Company* v. *Arkansas*, 235 U. S. 350, the tax was based "upon the proportion of the outstanding capital stock of the corporation represented by property owned and used in business transacted in this State." Sustaining the tax, Mr. Justice Pitney said (p. 363):

> "We therefore accept the construction * * * that it imposes an annual franchise tax upon the right * * *

to exercise corporate powers within the State, the amount of the tax being fixed solely by reference to *the property of the corporation that is within the State* and used in business transacted within the State," * * * [italics ours]."

(p. 365):

"Applying these principles, we have no difficulty in sustaining the tax in question as a legitimate imposition upon a foreign corporation with respect to its exercise of the privilege of transacting intrastate business in corporate form, the tax being based *upon the amount and value of its property within the State.* * * * the Act provides machinery for ascertaining *the market value of the entire capital stock* and striking a proportion between the value of the property owned and used by the corporation in the State and that owned and used by it outside of the State [italics ours]."

In *Hump Hairpin Co.* v. *Emmerson*, 258 U. S. 290, the tax was based on the amount of the authorized capital stock represented by property located and business transacted within the State. In sustaining the tax, Mr. Justice Clarke stated (p. 295) that:

"if computed on the *property admitted to have been in use in the State* it would be but slightly less than the tax collected."

Cheney Brothers Co. v. *Massachusetts*, 246 U. S. 147, followed *Baltic Mining Co.* v. *Massachusetts*, 231 U. S. 68, which is no longer law.

Cudahy Packing Co. v. *Hinkle*, 278 U. S. 460.

The reason that par value is a proper basis for computing the franchise tax on foreign corporations is that there is *some* relation between par value and actual assets.

P. ex rel. Farrington v. *Mensching*, 187 N. Y. 8.

III. The court failed to give effect to the doctrine of the *Farrington Case*.

The opinion of Judge Vann in *P. ex rel. Farrington* v. *Mensching, supra*, is a landmark in the law of arbitrary taxation. It was the basis of the decision in *P. ex rel. Terminal and Town Taxi Corporation* v. *Walsh*, 202 App. Div. 651, which, as is shown below, was the occasion for the enactment of the statutory provision here in question. Those two New York decisions were the basis of the taxpayer's argument in this court in the *Air-way Case*. There is no reason to suppose that had not this court decided the *Margay Oil* and *Gilliland Oil Cases* as it did, the Court of Appeals would not have followed the *Farrington Case* in expressing its opinion as to the constitutionality of the statute here in question in *P. ex rel. D. W. Griffith, Inc.* v. *Loughman*, 249 N. Y. 369.

Even if a foreign corporation can be said to "use" its issued shares in carrying on business within a state, the doctrine of the *Farrington Case* forbids taxing the privilege of carrying on such business by reference to the number of shares into which its capital happens to be divided. Certainly if the priivlege of transferring in the State of New York shares having different par values cannot under the Federal Constitution be taxed at a flat rate per share, then the privilege of carrying on business in the State of New York cannot be taxed at a flat rate per issued non-par share.

Judge Vann said (187 N. Y. 20):

> "• • • there is no plausible or possible reason why one hundred acres in a single field should not pay the same tax as one hundred acres of equal value in ten fields."

So, there is no plausible or possible reason why a foreign corporation employing $1,000 represented by 10 shares should not pay the same tax as another foreign corporation employing $1,000 represented by 100 shares.

> "• • • If the corporations have equal assets and are equally successful, the two lots of shares are exactly the same thing."

IV. The suggestion in the opinion, that a state extends to a foreign corporation any privilege with regard to the number of shares into which its capital stock is divided, is novel, was not considered by the courts below or raised in the argument before this court.

Here, again, the court refers to no authority, legal or economic, and enters into no further discussion.

Counsel desire an opportunity to show to the court that the assumption so made is baseless and that a foreign corporation receives no privilege whatsoever from any state, except the state of its incorporation, with regard to the number of shares into which its capital stock is divided.

Even if it is admitted that the carrying on of business "with non-par stock" is part of the privilege extended by a state to foreign corporations, the number of shares into which such stock is divided is not a reasonable basis for measuring such privilege. The state grants to the farmer the privilege of owning a farm, but the number of fields into which the farm is divided is not a reasonable basis for measuring this privilege.

When the court assumes that if the doing of business with a greater number of non-par shares is not deemed by the taxpayer to be a valuable privilege it will reduce the number of shares, it echoes the words of the statutory court in the *Air-way Case* (279 Fed. 878 at p. 889):

> "• • • If, when taxpaying time comes, its officers and stockholders find its authorized capital excessive, production of a needless financial burden, and harmful to them in their competition with others engaged in like manufacturing (and there are some thus engaged), there is no apparent impediment obstructing their reduction of such capital."

V. In considering the scheme of taxation adopted by the State of New York this court has disregarded the treatment of non-par stock for the purpose of the annual franchise tax.

The opinion refers to the scheme adopted by the State of New York for domestic corporations as being permissible under the doctrine of *Roberts & Schaefer Co. v. Emmerson*, 271 U. S. 50. That was a case of an annual franchise tax on domestic corporations; but the State of New York has not adopted any consistent scheme with respect to annual or initial taxes based on non-par stock, either of domestic or foreign corporations.

Under the provisions of Article 9-A of the *Tax Law* of this State, non-par stock of both domestic and foreign corporations is treated at its actual or market value but not less than $5 per share (*Tax Law*, §214). On the other hand, in the case of the organization tax on domestic corporations, an arbitrary rate is essential, for the tax is on authorized stock and it is impracticable to levy such a tax in any other manner. Far from being part of a consistent scheme of taxation of domestic and foreign corporations, the provision here in question is an anomaly and inconsistent with the other provisions of the *Tax Law*, as is shown by the history of the amendments of that law.

When domestic corporations were first authorized to have stock without par value in 1912, no particular provision was made for the computation of the license fee on foreign corporations having non-par stock. Article 9-A of the *Tax Law* providing for the annual franchise tax was enacted in 1917 and originally provided that non-par stock should be valued at the amount paid in. This latter provision was amended in 1920 (L. 1920, c. 640), so as to provide that non-par shares should be valued at $100 per share. No similar provision, however, was made with regard to the initial license fee. A foreign corporation having non-par stock representing about $8.55 per share was assessed for

both license fee and annual franchise tax on the basis of $100 per share. In a proceeding to revise this assessment, the Appellate Division for the Third Department held:

(1) That there being no authority under §181 for the assumption that non-par stock should be valued at $100 per share, the assessment of license fee must be based on the actual assets employed within the State;

(2) That the 1920 amendment valuing non-par stock at $100 per share for the annual franchise tax was unconstitutional.

P. ex rel. Terminal and Town Taxi Corporation v. *Walsh*, 202 App. Div. 651.

After the rendition of this decision, which was not appealed, the Legislature amended both §181 and §214 so as to contain substantially the provisions before this court (L. 1921, c. 705, §§3, 4).

It is apparent that the Legislature, instead of adopting a consistent scheme of treatment of non-par stock for the purposes of both annual franchise tax and initial license fee, went no further than was thought to be required by the actual holding in the *Terminal and Town Taxi Case*.

It is difficult to see what interest the State of New York has in maintaining a policy of taxing foreign corporations on the basis of six cents per share of their *issued* stock to the extent of the proportion allocated to the State of New York, in order to protect domestic corporations which are required to pay five cents per share on all their *authorized* non-par stock, whether issued or unissued and irrespective of what proportion of their assets are employed within the State.

VI. The suggestion in the opinion, that discrimination as between non-par stock and par value stock of foreign corporations may be based on a difference between the rights of creditors of the two classes of corporations, overlooks the fact that in some cases the discrimination may be in favor of the non-par corporations and against the par value corporations.

It is believed that the criticisms of non-par stock suggested by various writers referred to in the footnote of the opinion—whatever the validity of such criticisms—were not even remotely connected with the legislation here in question. The State of New York and the leaders of its Bar were the pioneers in the advocacy of this kind of stock. Among the distinguished New Yorkers whose recommendations were followed by the New York Legislature were Edward M. Shepard, Francis Lynde Stetson, F. W. Stevens, Victor Morawetz, Charles E. Hughes, Elihu Root, Louis Marshall and Frederick Strauss.

Wildman & Powell: Capital Stock without Par Value, pp. 15-32.

The defects alleged by Professors Bonbright and Berle, with regard to the liability of directors or of stockholders, existed as well in the New York as in other statutes. In fact the Delaware statute has now been amended so as to provide for the precise demarcation of capital from surplus (*Revised Code of Delaware*, c. 65, Sec. 14, as amended).

When the State of New York itself provides for the issue of non-par stock by its own corporations, having all of the defects which have been urged against that kind of stock generally, it can hardly be said that the existence of those defects is the basis of a discrimination made by the State of New York between foreign corporations having non-par stock and par value stock.

But if it were true that the Legislature, on account of the existence of such alleged defects in non-par stock, intended to discriminate against all corporations having that kind of stock, it signally failed to do so, because the statute here in question only discriminates against foreign corporations having non-par stock *representing less than $48 per share of paid in value.* A foreign corporation having 10,000 issued shares of the par value of $100 each and employing all of its assets in the State of New York is required to pay a license fee of 1/8 of 1%, *i. e.* $1,250; whereas a foreign corporation having 10,000 non-par shares issued for $100 per share is required to pay six cents per share, *i. e.* $600.

Surely the alleged differences in the rights of creditors of corporations having the two different classes of stock cannot be made the basis of a discrimination which operates in either of two directions according to the amount paid in on the non-par stock.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that the judgment of the Circuit Court of Appeals for the Third Circuit be, upon further consideration, affirmed.

Respectfully submitted,

RALPH MONTGOMERY ARKUSH,
JAMES I. BOYCE,
Counsel for Appellees-Petitioners.

Certificate of Counsel.

I, RALPH MONTGOMERY ARKUSH, counsel for the above-named appellees-petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

RALPH MONTGOMERY ARKUSH,
Counsel for Appellees-Petitioners.